SUPREME COURT OF THE UNITED STATES.

Term, 1944.

No.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The Trial Judge wrote no opinion. The opinion of the Circuit Court (both majority and dissenting) appears in the record at pages 120-140 and is reported in the Advance Reports of the Federal Reporter, 2nd series, at 145 F. (2nd) 316.

JURISDICTION.

The grounds on which jurisdiction of this Court is invoked is set forth in the petition at page 9 thereof.

STATEMENT OF THE CASE.

The statement of the case appears in the Petition at pages 2 to 8, and in the interest of brevity is not repeated.

SPECIFICATION OF ERRORS.

The errors which petitioner will urge, if writ of certiorari be granted, are that the Circuit Court of Appeals for the Third Circuit erred:

1. In issuing the peremptory writ of mandamus dated January 23, 1945.

2. In holding that an interlocutory and discretionary order (of reference to a Special Master) of the District Court Judge is subject to review or control by mandamus in the Circuit Court.

3. In holding that Rule 23 (c) of the Rules of Civil Procedure does not justify an investigation (through the medium of a reference to a Special Master) in a class suit compromised, without submission for approval of the Trial Judge, by the medium of the defendant corporation's pur-

chase of the stock interests of the plaintiff and others in the class, at prices fixed by the defendant corporation, accompanied by misrepresentations as to the value of the stock and the financial condition of the defendant corporation, the failure to disclose material and relevant facts relating to the value of the stock thus purchased, and the payment of incredibly exorbitant "commissions" to counsel for the plaintiff for securing transfer of the stock from plaintiff and others in the class to the defendant corporation.

4. In holding that despite the prayer for the appointment of a receiver and the allegations of fraud and domination in the complaint, the reference to a Master was improper.

STATUTES INVOLVED.

No statute is involved, but Rules 23 (c) and 53 of the Federal Rules of Civil Procedure (28 U.S.C.A. following Sec. 723) are involved.

ARGUMENT.

INTERLOCUTORY, DISCRETIONARY ORDERS OF THE DISTRICT COURT ARE NOT SUBJECT TO CONTROL OR REVIEW BY MANDAMUS IN AN APPELLATE COURT.

An Order of reference to a Special Master is an interlocutory order:

> Grant v. Phoenix Mutual Life Insurance Company, 121 U. S. 118: 7 Sup. Ct. 849; 30 L. Ed. 909;

Deckert v. Independence Shares Corp., 311 U. S. 282; 61 S. Ct. 229; 85 L. Ed. 189, 195 Note 4;
Dooley v. Fritz, 45 F. (2nd) 317 (C.C.A. 1).

An Order of reference to a Special Master is discretionary with the Court:

In the Matter of Walter Peterson, 253 U. S. 300; 40 S. Ct. 543; 64 L. Ed. 919, 925;
Veneri v. Draper, 22 F. (2nd) 33 (C.C.A. 4);
53 C. J. page 700, Sec. 58;
4 C. J. page 256, Sec. 129.

Mandamus does not lie to control, review or reverse an interlocutory, discretionary order of the court below:

38 C. J. 656, Sec. 194;
Ex Parte Wagner, 249 U. S. 465, 39 S. Ct. 317; 63 L. Ed. 709;
American Construction Co. v. Jacksonville, T. & K.W.R. Co., 148 U. S. 372; 13 S. Ct. 758; 37 L. Ed. 486, 489;
In re Cohen, et al., 107 F. (2nd) 881 (C.C.A. 5);
National Bondholders Corporation v. McClintic, 99 F. (2nd) 595, (C.C.A. 4).

In ex parte Wagner, supra, this Court said at 63 L. Ed. 713:

"Mandamus is an extraordinary remedy, to be resorted to for the purpose of securing judicial action, not for determining in advance what that action shall be (Re Rice 155 U. S. 396, 39 L. Ed. 198, 15 Sup. Ct. Rep. 149). It may not be resorted to, as the petitioners seek to resort to it here, for the purpose of controlling minor orders made in the conduct of judicial proceedings, and the fact that the result of litigation may possibly be such that interlocutory proceedings taken may not prove of value is not a sufficient

reason for calling the writ into use for the purpose of forbidding such proceedings, *even though the cost of them cannot be recovered from the opposing party* or even though the order cannot be reversed on error or appeal. Ex parte Newman, 14 Wall. 152, 165, 168, 20 L. ed. 877, 879, 880. This from American Construction Co. v. Jacksonville T. & K.W.R. Co. 148, U. S. 372, 379, 37 L. ed. 486, 489, 13 Sup. Ct. Rep. 758, is sharply pertinent to the application before us:

" 'Least of all can a writ of mandamus be granted to review a ruling or interlocutory order made in the progress of a cause; for, as observed by Chief Justice Marshall, to do this "would be a plain evasion of the provision of the act of Congress that final judgments only should be brought before this Court for re-examination;" would "introduce the supervising power of this Court into a cause while depending in an inferior court, and prematurely to decide it"; would allow an appeal or writ of error upon the same question to be "repeated, to the great oppression of the parties"; and "would subvert our whole system of jurisprudence." (Italics supplied.)

It is clear, then, from the authorities cited that an order of reference to a Special Master is interlocutory and discretionary in nature, and in consequence mandamus does not lie in the Circuit Court to control, review, reverse or set aside the order.

THE ORDER COMPLAINED OF WAS JUSTIFIED AND PROPER UNDER THE PROVISIONS OF RULE 23 (c) OF THE FEDERAL RULES OF CIVIL PROCEDURE.

That rule provides as follows:

"A class action shall not be dismissed or compromised without the approval of the court. . . . If the

right is one defined in paragraphs (2) or (3) of subdivision (a) notice shall be given only if the court requires it." 28 U.S.C.A. following Sec. 723.

That the class action in the District Court *had* been compromised is not open to doubt.

It is perfectly true that the record does not show any formal agreement of compromise. Counsel for plaintiff in the District Court, however, several times stated that the litigation had been "settled" (R. 75); he stated that he no longer had a client (R. 74); and that Eisenlohr had bought out most of the outstanding preferred stock whose owners constituted the class interested in the litigation (R. 75).

Any contention that the litigation was not compromised by the purchase of these shares of preferred stock is disingenuous. The truth is that Eisenlohr had simply bought out the opposing litigants. It had bought out their stock at $150.00 a share (R. 35), although later it apparently thought it wise to redeem the unbought shares at the considerably higher price authorized by the charter (R. 136). The purchase from those stockholders who sold at $150.00 was accompanied by fraudulent misrepresentations and by the payment of what the dissenting opinion below called "astonishing commissions"—to whom? to counsel for the plaintiff and for others in the class.

A compromise need not be denominated as such to constitute a compromise. Let it be called what one will, a defendant's purchase of the corporate stock which alone gives the plaintiff the status to carry on the litigation as plaintiff is a compromise of the suit. Naturally, if no one remains to carry on the suit, the litigation must fall or be dismissed. This is what happened in the District Court litigation; and what happened brought the transaction directly within the terms of Rule 23 (c) supra.

That there was no motion for dismissal or compromise is without significance. The rule does not speak of a motion. It makes approval of dismissal or compromise mandatory;

in other words, a class suit *may* not be dismissed or compromised without approval.

The litigation in the District Court in this case *was* compromised without approval, and Rule 23 (c) implies a positive duty on the Trial Judge to give approval or withhold it. It is elementary that the Trial Judge is vested with whatever incidental or implied powers are necessary in order to exercise the expressed power of approval or disapproval. Among those incidental or implied powers must be included the power to investigate the circumstances surrounding the compromise. Any other interpretation or construction would shackle his hands. It would be idle to impose upon the Trial Judge the duty to approve a compromise if the means of learning the facts which he must have before he can exercise his judgment are withheld from him.

The facts in the District Court litigation could well be considered a classical illustration of the wisdom of Rule 23 (c). It is perfectly inferable from the record (and from any practical viewpoint it is the fact) that holders of preferred stock of the defendant Eisenlohr had been induced by misrepresentation and withholding of essential information to sell the stock back to the corporation at less than its value: i.e. had been thus induced to *compromise* the issue at a lesser figure than they should have received, and than they probably would have demanded, had proper disclosure and no misrepresentation been made.

Biggs, J. in the dissenting opinion below has pointed out (R. 135) how the preferred stockholders could have been (and undoubtedly were) misled by the defendant company's annual report for the year 1942 sent to stockholders on March 23, 1943.

The shocking factor which appeared in the company's efforts to purchase the preferred stock was the misleading statement in the annual report—the statement that the net earnings of some $235,000.00 for the year 1942, were equivalent to 49¢ per share on the common "after allowance for unpaid preferred dividends accrued" in 1942 (R. 27).

This amounted to a statement that the company had earned only $7.00 per share (the stipulated dividend) on the preferred stock for 1942. The statement was false. The company had earned almost $47.00 per share of preferred stock for 1942 ($235,751.73 divided by 5037) (R. 27, 49, 54). Common stock could not, of course, receive dividends until all arrearages of dividends on preferred had been paid; therefore, in cold fact, there were no earnings on the common "after allowance for unpaid preferred dividends".

Naturally, holders of preferred stock, who were informed by the company that their stock had earned only $7.00 per share for 1942, would be willing to sell the stock at a much lower price than if the truth had been disclosed to them—that the earnings were almost $47.00 per share, whether available for actual dividend payments or not.

Furthermore, earnings for 1943 were mounting still higher. The company made earnings in the *first quarter* of 1943 equivalent to $26.00 per share of preferred stock (R. 52). This fact, as shown, was not disclosed to the holders of the preferred stock.

Here was a company which, in the last fifteen months, had earned about $73.00 per share on the preferred—almost enough to wipe out the accumulated arrearages of dividends in the preferred in the amount of $82.25 per share. The preferred had brought suit to wrest control of the company from those elected and appointed by the common stockholders. What did the latter do?

They immediately embarked upon a plan to buy out all the preferred at $150.00 per share, although its redemption value was $197.25. They misrepresented the earnings on the preferred for 1942, and they failed to disclose the earnings for the first quarter of 1943. Everett Meyer, the president, commenced to buy large blocks of common stock. The company offered a lawyer, counsel for the plaintiff in the suit, a brokerage fee of *$750.00 per hundred share certificate* for any stock which he induced his clients to sell. This brokerage fee should be contrasted with the normal broker-

age figure of about *$35.00 per hundred share certificate*. Since counsel for the plaintiff had taken the position that he controlled or represented some 1200 shares of preferred, this meant that he would earn brokerage fees in the amount of some $9,000.00 for "assisting" the company to purchase the stock from those he represented or controlled.

Counsel for the plaintiff accepted the offer for brokerage fees, and the plaintiff, among others, sold his preferred stock.

Whether or not the circumstances concerning Eisenlohr's purchase of the preferred stock were an issue in the litigation at its inception or during its course, they certainly became issues when Eisenlohr began to work out the compromise and finally effectuated it. Accordingly, it was not only within the power of the trial judge to investigate those facts (so that he might exercise the duty imposed upon him of approval or disapproval), but it became his *duty* to investigate those facts. Since such investigation would be futile without an examination of the financial resources and status of the defendant corporation, which involved complicated figures and accountings, it was proper under Rule 53 to refer those issues to a Special Master, under well settled rules of law.

The petitioner in this Court contends, therefore that—passing by the power of the Circuit Court to control the referral to a Special Master by mandamus—the order of reference was nevertheless proper, justified and necessary.

THE ORDER WAS JUSTIFIED BY THE PRAYER FOR A RECEIVER AND THE ALLEGATIONS OF FRAUD AND DOMINATION IN THE COMPLAINT.

At the time the order of reference was made the suit had been compromised, but not dismissed. The Bill of Complaint still possessed vitality. Others in the class might intervene or join in the litigation. The complaint averred

that the Chase National Bank of New York through its ownership of a large block of common stock dominated and controlled the defendant, Eisenlohr, and that the assets and property of the company were being managed, controlled and disposed of for the sole benefit of the holders of the common stock to the injury and prejudice of the preferred stockholders.

At the time of the order of July 9th, there were still holders of preferred stock. If it developed that the averments of the complaint were true, there was still suffering from the acts complained of and it was still possible that the situation called for the appointment of a receiver. The matters which the order of reference required the Special Master to investigate and report upon were also germane to the question of such an appointment, as well as to the question of a compromise. Accordingly, from that viewpoint there was still entire justification for the order of reference.

APPLICABLE EXCERPTS FROM THE DISSENTING OPINION BELOW.

> "On the question of possible abuse of the court's discretion, referring specifically to the conduct of Webster Eisenlohr, Inc., I think it is apparent that that company's annual report for the year 1942, sent to stockholders on March 23, 1943, was lacking in candor. A preferred stockholder, unversed in corporate law, might have gathered from the report that despite the fact that the company had a net operating profit for the year 1942 in excess of $235,000, a sum sufficient to reduce the arrearage of accumulated dividends on the preferred stock by approximately 75%, only the sum of $7 per share was immediately available for the preferred stockholders, the balance being allocable to the common stock." (R. 135.)

"It appears also that Webster Eisenlohr, Inc. paid the sum of $750 per 100 share certificate to the plaintiff's attorney for the preferred stock which his clients, or those with whom he got in contact, sold to the company. This is an astonishing commission; more than 2,000% above that permitted to a broker on a regulated exchange. The brokerage house acting for the company also received a fee of $10,000 as compensation for its efforts in acquiring preferred stock for the company. It does not appear that the nature and extent of the brokerage fees were made known to the preferred stockholders. The consideration of these items might well have lead Speese and the preferred stockholders associated with him in his litigation to hold their stock for higher prices." (R. 136.)

"While no motion for the compromise, settlement or dismissal of Speese's suit has been filed in the District Court, it is clear that if all of the preferred stock has been purchased or redeemed by the company, the case has in fact been compromised and is ripe for dismissal." (R. 137.)

"If the court is to approve the compromise it is necessary that the court be informed fully as to the circumstances of the compromise. The court, therefore, is entitled to make use of the instrumentality of a master to inform itself in the premises. For these reasons the District Court now is entitled to make an order of reference to a master similar to the order complained of. It follows that the appellate tribunal should not issue a writ of mandamus to compel the District Court to vacate its existing order." (R. 137.)

"Since the complainant prays for the appointment of a receiver and alleges that the property of the corporation has been used for the benefit of the common stockholders in derogation of the rights of the preferred stockholders, the court was entitled to make use of a master in order to advise itself in the premises. See

Ex parte Peterson, 253 U. S. 300; In re Utilities Power & Light Corporation, 90 F. (2nd) 798, 800." (R. 133.)

Petition in this Court therefore contends that

(a) The Court below erred in issuing the Writ of Mandamus directing the Trial Judge and the other Judges of the District Court to set aside the order of reference, since mandamus does not lie to control, review or reverse an interlocutory and discretionary order (such as an order of reference).

(b) The order of reference was necessary and required both under Rule 23 (c) and because of the prayer for the appointment of a receiver and the averments of fraud and domination in the complaint.

(c) The order of the Court below constituted by the peremptory Writ of Mandamus should be reversed.

Respectfully submitted,

HIRSH W. STALBERG,
Attorney for Petitioner.

Appendix

ORDER AMENDING ORDER OF JUNE 9, 1943.

AND NOW, to wit, this 13th day of November, 1944, the Order made by this Court June 9, 1943 is amended as follows:

1. That David Bortin, Esq., of Philadelphia, Pennsylvania, is hereby appointed Special Master in the above-entitled cause under Rule 53 of the Rules of Civil Procedure, with the duties and authority set forth below.

2. Said Special Master is hereby directed to investigate: the acts, conduct, property, liabilities, financial condition, books, records and assets of the Defendant; all the circumstances relating to an Offer made March 26, 1943 to the Holders of 7% Cumulative Preferred Stock of the Defendant; the arrangement made by and between the Defendant with White, Weld and Co. of New York and Bertram K. Wolfe, Esq. with reference to the Offer made to the Preferred Stockholders; the conduct of the Board of Directors of the Defendant with reference to the making of said Offer to the Preferred Stockholders; the propriety, reasonableness and adequacy of the said Offer to the Preferred Stockholders; and any other matters which may be referred to the Special Master by the Court as relevant to these proceedings.

3. Said Special Master shall, at the earliest date practicable, prepare and submit a report of the foregoing investigation and recommendation to the Court. Said Special Master shall further prepare a summary of such report and recommendation in such manner as the Court shall direct and the same shall be submitted to the creditors and stockholders of the Defendant.

4. Said Special Master is authorized to examine the Di rectors and Officers of the Defendant and any other wit nesses concerning the foregoing matters or any of them.

5. Said Special Master is directed to report to the Cour any facts ascertained by him pertaining to fraud, mis conduct, mismanagement and irregularities in the conduc of the affairs of the Defendant and/or the Offer to the Pre ferred Stockholders.

6. Said Special Master may, upon further order of th Court, employ such person or persons as the Court may deem necessary for the purpose of assisting the said Specia Master in performing the duties hereby imposed upon hi

7. Said Special Master shall give at least 10 days' notic of his appointment, of the matters referred to him, and o the time and place fixed by him of a hearing thereon, b publication in the Legal Intelligencer and one newspape published in Philadelphia, Pennsylvania and one newspape published in New York, New York, and by notice mailed t the Preferred Stockholders of the Defendant and to th parties to this cause of their address of record.

8. IT IS FURTHER ORDERED that the reasonabl expenses and compensation of the Special Master shall b charged against the parties in such proportion and in suc manner as the Court may at the conclusion of the case, i its discretion, determine and order.

By the Court,
KALODNER,
J.